COMPLIANCE ELLIANCE JOURNAL

DOES GERMANY NEED A NEW CORPORATE SANCTIONING ACT?

Sebastian Jungermann

AUTHOR

Dr. Sebastian Jungermann is a German lawyer at Arnold & Porter Kaye Scholer in Frankfurt. He specialized in competition law, compliance and internal investigations. Sebastian Jungermann advises clients regarding German and European competition and antitrust laws, including German, EU and multi-jurisdictional merger control proceedings, cartel proceedings, abuse-of-dominance proceedings, litigation, and compliance programs, as well as internal audits and contractual advice. Dr. Jungermann further advises in the fields of corporate law, national security, foreign investments and export control, IP, data protection and privacy (GDPR), outsourcing and other technology-related areas. In addition, he is involved in international litigation, including pre-trial discovery proceedings in support of US litigation.

ABSTRACT

In summer 2019 the German Federal Ministry of Justice has unveiled a draft Corporate Sanctioning Act (Verbandssanktionengesetz) to combat corporate crime. In this article, the author comments on the intended changes and highlights some issues that could be better solved differently in practice.

TABLE OF CONTENTS

I. INTRODUCTION

Early 2018, the political parties leading the new German government proposed far-reaching changes to the criminal law for companies, they have agreed to provide a new system of corporate sanctions. In August 2019, the German Federal Ministry of Justice unveiled a draft Corporate Sanctioning Act (*Verbandssanktionengesetz*) to combat corporate crime. At the time of writing this article, the draft was still under tight wraps. As promised in the German coalition agreement between the Conservatives and the Social Democrats, CDU, CSU, and SPD, dated 2 February 2018 (p. 126), the intention of the political parties was to update the sanctions law for companies, to increase corporate penalties and to provide a new system of corporate sanctions. The new draft bill of a Corporate Sanctioning Act shall now introduce corporate criminal liability for business-related criminal offences, facilitate appropriate punishment of criminal offences related to corporations, promote internal investigations, and shall incentivize investments in compliance.

As of now, applicable German law basically does not provide for criminal liability in the narrower sense of legal persons and associations of persons. This is justified by the (still) predominant opinion that only an individual has the capacity to act (*Handlungsfähigkeit*), can have criminal responsibility (*Schuldfähigkeit*) and can have the ability to be punishable (*Straffähigkeit*). All this does not apply to legal persons, corporations, and associations of persons.

Since the Middle Ages, the question of whether misconduct in a company or association is sufficiently sanctioned and whether Germany needs corporate criminal law has been the subject of controversy. Important discussions have been published by *Malbranc* in 1793 (*Observationes quaedam ad delictas universitatum spectantes*), where he opposes the possibility of attribution of guilt to *universitas*, and the potential criminal liability. Other renowned law scholars, among them *Feuerbach*, joined forces to this view. The fiction theory of *Savigny* was also important, according to which legal entities do not consider their quality as legal entities to be a mere natural person, to thinking, wanting and feeling beings, but a fiction. Such a fiction could be accepted in civil law, but would not be sufficient as a basis for criminal punishment. These opinions have been reflected in the German criminal laws of the 19th century, in particular in the Prussian Criminal Code (*PreußStGB*) of 1851 and the Imperial Criminal Code (*ReichsStGB*) of 1871.

The current discussions have been reinitiated in 2013 with the presentation of the "Draft of a law for the introduction of criminal responsibility of companies and other associations" from North Rhine Westphalia (*NRW*). In 2014, the German Institute for Compliance (*DICO*) submitted a daft "Compliance-Incentive-Act" proposal, suggesting to modify §§ 30 and 130 of the German Regulatory Offences Act (*OWiG*) accordingly. In the same year, also the German Federal Association of Corporate Lawyers (*BUJ*) submitted a "legislative proposal for an amendment to §§ 30, 130 OWiG", which takes a slightly different approach. In December 2017, the University of Cologne then presented the "Cologne Draft of an Association Sanctioning Act" and early September 2019, an alternative

draft to the ministerial draft bill was introduced, the so-called "Munich draft of a Corporate Sanctioning Act".

II. CURRENT GERMAN FRAMEWORK FOR SANCTIONS FOR CORPORATE MISCONDUCT

Under German law, companies are sanctioned de lege lata for misconduct on the part of employees and managers by setting an association fine in accordance with § 30 OWiG. According to this, a fine can be imposed on a company if a manager has committed a criminal offence or an administrative offence, a so-called attachment offence (*Anknüpfungstat*), which has violated the company's association-related obligations. According to § 130 OWiG, the imposition of an association fine may also be linked to the violation of a supervisory duty by the owner of a business or enterprise. Other persons acting on behalf of the holder may also be prosecuted. According to § 47 OWiG, it is the duty of the competent authority to decide whether an association fine will ultimately be imposed; the principle of opportunity applies (*Opportunitätsprinzip*). In 2013, the amount of a fine imposed by an association was increased tenfold to 10 million Euros. In addition to this penalty component, it is also possible to skim off any unlawful profits, whereby this disgorgement may exceed the maximum amount of the fine. As a secondary consequence, the expiration of "the obtained" can be ordered.

III. THE PROPOSED CORPORATE SANCTIONING ACT

As pointed out above, recent discussions in criminal theory and legal policy have brought forward the arguments that current German laws for penalizing company-related criminal offences is insufficient. Politicians and others have proposed the introduction of new statutes for penalizing corporations, in particular for the following reasons and with the following proposals:

A. Principle of Opportunity

The German Regulatory Offences Act (*OWiG*) is subject to the principle of opportunity (*Opportunitätsprinzip*), and thus to discretionary prosecution. Based on that principle, some criminal corporate offences are not being prosecuted at all in practice, while others are. Given the significant difference in funding and support for public prosecutors all over the sixteen German states (*Bundesländer*), there are indeed also regional differences in prosecuting misconduct within corporate structures in practice. This was also raised in the coalition agreement dated February 2018, where the parties formulated: "We want to ensure that companies that profit from the misconduct of their employees are also penalized more severely in the event of white-collar crime. So far, it has been left to the discretion of the competent authority whether the undertaking concerned should also be prosecuted. By moving away from the opportunity principle of the previously relevant regulatory offence law, we are ensuring uniform application of the law throughout Germany." The opportunity principle of the OWiG is indeed applied quite differently by public prosecutors throughout Germany. The intention was a uniform application of the

law. A study carried out in North Rhine-Westphalia (*NRW*) among 45 larger specialist public prosecutors' offices for economic and corruption proceedings has shown that not even in every fifth case a fine was imposed on the company, although this would have been possible. The proposal from NRW envisages integrating the criminal liability of legal entities, associations not having legal capacity and partnerships having legal capacity into the scope of application of the Criminal Code. The principle of legality (*Legalitätsprinzip*), which provides an obligation to prosecute, applies within the Criminal Code.

The Federal Ministry of Justice now seems to implement that principle of legality into its draft Corporate Sanctioning Act. If that proposal will become law, some German states have to invest heavily to increase forces and expertise to reach that obligation. Prosecutors will be obliged to initiate preliminary criminal investigations against a corporation upon sufficient reasonable suspicion that a criminal offence has been committed. Discretionary considerations, such as understaffed authorities or potentially lengthy investigations, which is often the case with international matters, will no longer constitute grounds for waiving criminal investigations. The available options to discontinue investigations on discretionary grounds under the Criminal Code (§§ 153, 153a StPO) will apply by analogy, though. However, the fact that the company has already suffered serious consequences or has conducted an internal investigation, may lead to investigations being abandoned.

B. Financial Penalties, a Formal Warning, a Monitor and the Death-Sentence

The current maximum fine is limited to 10 million Euros under German law (§ 30(2) OWiG). It is argued that this only constitutes a calculable risk for companies. On one side, the range seems to be too low for larger companies and too excessive for smaller companies. Although disgorgement may result in heavy fines, it is not a criminal penalty as such. Penalties for corporations under the German OWiG only may fail to reflect the seriousness of the issue and the damages done to society by corporate misconduct. Criminal law has a stronger deterrent effect than regulatory law. In addition, specific corporate criminal laws have become standard internationally. Not only 21 of the 28 EU-Member States and the United States, but also half of the OECD countries have established rules and legislation targeting corporate criminal activities.

In the coalition agreement from February 2018 the political parties agreed to the following: "We will extend the sanctions instruments: the current maximum fine of up to ten million Euros is too high for smaller companies and too low for large groups. We will ensure that the amount of the fine is geared to the economic strength of the company in the future. For companies with a turnover of more than 100 million Euros, the maximum limit should be 10 % of the turnover. We are also creating further sanction instruments. In addition, we create concrete and comprehensible assessment rules for corporate money sanctions. The sanctions shall be made public by appropriate means." And: "We are also increasing the legal security of the companies concerned through clear procedural rules. At the same time, we will create specific rules on the termination of proceedings in order to give judicial practice the necessary flexibility in prosecution."

It was often criticised, that defence rights under German law in company-related investigations have not been existent and rather inadequate. Defence rights have aimed at the individual, not at an association, and legal certainty is urgently needed here.

The proposed Corporate Sanctioning Act provides for three types of penalties for corporations: (1) a financial penalty relating to the corporation, (2) a warning, reserving the right to impose a financial penalty, and (3) as a final resort, dissolution of the corporation.
In addition and as agreed, financial corporate penalties shall be significantly higher for companies with an annual turnover of more than 100 million Euros. In cases of intent, the penalty will range from a minimum of 10,000 Euros up to 10% of the average annual turnover; in cases of negligence it shall still be 5,000 Euros up to a maximum of 5% of the average annual turnover. The average annual turnover to be set is calculated on the basis of the global turnover of all corporations operating as an economic unit over the last three financial years. The relevant date shall be the date of the sentencing decision.
Similar fines are also available under antitrust law (10 % of the worldwide turnover) and data protection law (4 % of the worldwide turnover), which may lead to disproportionately high penalties. In addition, the new draft Corporate Sanctioning Act also introduces the possibility of confiscation (§ 73 et seq. StPO), which is similar to disgorgement under the German antitrust law (§ 34 GWB).
The timing to calculate the turnover may impose major risks in M&A transactions as well. Concerning a share deal, and in case the target is integrated into the buyers group, which is often the case, the base for the fine may be increased significantly. Similar risks will be seen in case of an asset deal. All this may create the risk of excessive and disproportionate corporate penalties under the new law.

However, mitigation provisions apply if the company has in fact contributed to clarifying the corporate misconduct by conducting an internal investigation and cooperation with the prosecutors. Another option to end the official proceedings under the proposed Corporate Sanctioning Act is the issuing of a formal warning while reserving the right to impose a financial penalty. This warning option may apply where it is expected that (1) a warning suffices to prevent future corporate misconduct, (2) an overall assessment of all circumstances deems the imposition of financial penalties unnecessary, and (3) the maintenance of the legal order does not require penalties.
In such situations, the court may impose conditions and directives for the period of one to five years in which the right to impose a penalty is reserved. In particular, a court may order the implementation of a more efficient and stricter internal compliance system and the appointment of an external expert as compliance monitor to prevent further corporate misconduct. Such warning is somehow similar to the non- and deferred prosecution agreements as known in other jurisdictions, like the U.S., UK, and France. It is proposed to also incorporate such option into German law as an alternative way of ending criminal proceedings. However, in case the requirements mentioned above will not be met, the court may reserve the right to impose up to 50 % of the penalties if this is sufficient to prevent future corporate misconduct. Moreover, the prosecutor may provisionally waive an indictment and impose conditions and issue instructions instead (which is similar to § 153a StPO).

As ultima-ratio, the dissolution of the company is possible in extreme cases, the death-sentence so to speak. For example, when a senior manager "persistently commits serious corporate offences" or when "the continued existence of the corporation increases the risk of serious corporate offences to be committed".

C. Internal Investigations, Sharing Internal Documents and Records

Considering internal investigations, there are currently no statutory provisions under German law on how to conduct such investigations in order to establish the facts and circumstances. There are no standards yet which take into consideration such investigative attempts and cooperative behaviour. Moreover, the German Code of Criminal Procedure (*StPO*) does not touch upon the circumstances in which corporations might have to grant prosecutors and investigative authorities access to their internal investigation records.

In the coalition agreement dated February 2018 the political parties agreed: "In order to create legal certainty for all parties involved, we will create legal requirements for internal investigations, in particular with regard to confiscated documents and search possibilities. We will provide legal incentives for internal investigations to provide clarification assistance and for the subsequent disclosure of the findings."
There is great legal uncertainty as to whether and how the protection against seizure of legal opinions, interview records and other documents within the framework of internal investigations should be designed. Also the German case law is quite contradictory. The introduction of clear rules on the prohibition of seizure and exploitation in the sense of a "legal privilege" would be a sensible approach and urgently required. The German Constitutional Court (*Bundesverfassungsgericht*) decided in July 2018 on the searches of Volkswagen's law firm in the diesel affair and ruled, that the seizure of internal documents and reports during a law firm raid in March 2017 was in line with German Constitutional law. The analysis of these rulings has been quite contradictory as well, and legal certainty is still urgently required.
Today, a complete and sincere cooperation can often lead to a suspension of proceedings or milder sanctions. However, these decisions are largely at the discretion of the authorities. In May 2017, the Federal Court of Justice (*Bundesgerichtshof*) mitigated the impact of compliance efforts. Clear rules on the benefits of cooperation and disclosure of any findings would be welcome.

The new draft Corporate Sanctioning Act allows for a reduction in penalties imposed on corporations in the event that internal investigations are conducted, if the following requirements have been met: (1) the internal investigations must be independent and not conducted by the corporation's defence counsel, and it must provide a material contribution to clarifying the corporate misconduct, (2) the corporation must cooperate continuously and unrestrictedly with the prosecutors, and the results of the internal investigations, the relevant and essential documents and the final report on the internal investigations must be disclosed to the prosecutors, and internal investigations must be conducted in compliance with fair trial principles. The latter requires, that employees must be in-

formed that the information they provide may be used against them in criminal proceedings, prior to the interview, interviewees must be given the possibility to retain their own lawyer or have a member of the works council present during the interview, and interviewees must have the right to refuse giving testimony if the response to such questions would otherwise expose him or her or any of their relatives to prosecution for a criminal or regulatory offence, and the internal investigations must be conducted in compliance with the applicable laws and documented appropriately. The requirements for such internal investigations seem to be quite high and it remains to be seen, how parties will deal with such requirements if enacted. However, such approach indeed provides a first framework for conducting internal investigations under German law, and if companies comply with the requirements mentioned above for internal investigations and cooperation, they do have a chance that prosecutors may refrain entirely from prosecuting the corporation until the internal investigation is completed.

However, the proposed amendment of the protection from seizure (§ 97(1) No. 3 StPO) may be cause for serious concern. The legal privilege and protection from seizure under German law will be limited even further. The draft Corporate Sanctioning Act proposes that all records and documents in the custody of lawyers may be seized unless the client in question is formally a defendant in criminal proceedings. For such relationship, a "relationship of trust" must exists concerning the documents. It is also not clear, whether and to what extent attorney work products prepared in the context of an internal investigation, like interview minutes, draft and final reports and presentations, shall be protected from seizure. It is also unclear, what kind of rights the defendant may have and how the legal privilege shall work, in case the internal investigation runs parallel to criminal proceedings, and how to deal with the separation between internal investigators and corporate counsel. It may be appropriate to make clear that a "relationship of trust" exists regardless of any formal position as internal investigator or defence counsel, and the German legal privilege and protection from seizure should cover all attorney work products of an internal investigation, at least when the investigation runs parallel to the criminal proceedings. One major problem under German law is the approach, that if an internal investigation is conducted prior to criminal proceedings, and before the corporation has been formally deemed a defendant, it seems that such documents are not protected from seizure and no legal privilege exists because the corporation is not yet a defendant. The proposed approach would constitute major issues and may lead to an unacceptable weakening of the rights of companies to defend themselves.

D. Corporate Penalty-Register

The draft Corporate Sanctioning Act also provides for a register, to be organized by Germany's Federal Ministry of Justice. Final decisions on imposing penalties or fines on corporations shall be entered into this register, together with data required to identify the corporation, the criminal or administrative offence in question and the applied provisions. However, only prosecutors, public authorities and courts may receive unlimited access to the new register, and only upon express request.

E. Incentives to Invest in Compliance

Finally, the draft Corporate Sanctioning Act also provides for certain incentives for investments in compliance programmes. First, existing compliance measures can initially be taken into consideration when assessing the amount of a penalty. Thus, the draft Corporate Sanctioning Act takes the ruling of the Federal Court of Justice (*Bundesgerichtshof*) dated 9 May 2017 into consideration. The compliance set-up of a company may be decisive for choosing the type of sanction to be imposed, and the court may also order to instruct an external compliance monitor, as described above. The compliance monitor should be selected and must be paid by the corporation, while the engagement is subject to the court's approval. And it is expected that the compliance monitor shall prepare reports and expert opinions for the court.

IV. OUTLOOK AND REMARKS

The German Corporate Sanctioning Act is to enter into force two years after its promulgation, which shall give companies sufficient time to check their internal processes and to implement additional compliance measures if necessary.

However, if judging the arguments, one must simply state that there is no legally compelling necessity for the introduction of Corporate Sanctioning Act. But there is also no doubt that the procedure for sanctioning corporations needs improvement. This need cannot necessarily be satisfied by means of criminal law. From a political point of view, however, the time is evidently ripe for a corporate criminal law also in Germany. Too many jurisdictions with similar legal traditions have moved on into such direction. A genuine corporate criminal law like the new draft Corporate Sanctioning Act does not seem to be advisable, because for reasons set out above, such approach is quite far away from the German legal culture. But even though there are many good arguments to keep the current system and to empower the current criminal and regulatory sanctions law with more life, for example by investing into manpower and expertise in many German states, it appears the time has come for moving on. The coalition's demands perfectly fit into the political climate.

Very often the accusation that criminal law *de lege lata* does not have sufficient preventive effects and that large companies take calculable risks, does not seem to be right. Already today the costs for internal investigations, fines and civil law consequences are very high and represent large burdens and risks. The allegation that cases of "organised irresponsibility" give rise to unacceptable gaps in criminal liability is also exaggerated. Even in the case of complex organisational corporate structures, the individual perpetrators must generally be identified, so that culpable failure of corresponding supervisory structures can be prosecuted. All it needs is a system with sufficient resources at the levels of the prosecutors and the courts.